

Business

Ukraine Warns of Gas Crisis as Negotiations With Russia Drag On

By [Vanessa Dezem](#)

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► Talks have stalled over pipeline transit fees after 2019

► Minister says it's 'highly probable' deal isn't made in time

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Ukraine is warning European nations to prepare for a gas crisis amid skepticism it will agree on a new transit contract with Russia before the current deal expires.

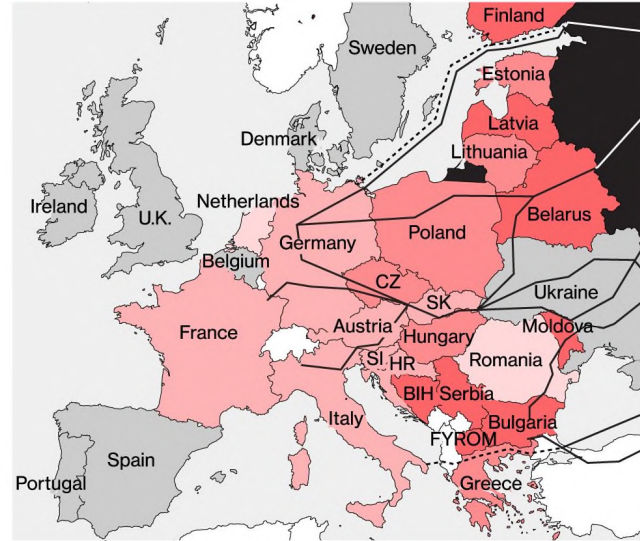
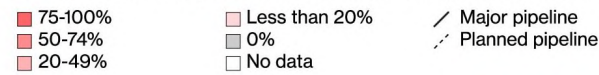
It's "highly probable" that a new accord won't be concluded by Jan. 1, when the current agreement ends, according to Ukraine's deputy foreign minister Olena Zerkal. That echoes skepticism by the nation's gas company [this week](#) for a deal on shipping fuel from Russia, Europe's biggest supplier, to regional consumers through the linchpin transit country.



"While Russia holds off the negotiations on future contract, the gloomy scenario of a gas crisis shall be considered seriously," Zerkal said by telephone from The Hague. "That is why every European nation, including Ukraine, is increasing gas stock in storage sites."

Who's Dependent on Russia's Gas?

Fourteen countries get more than 50% of their gas from Russia



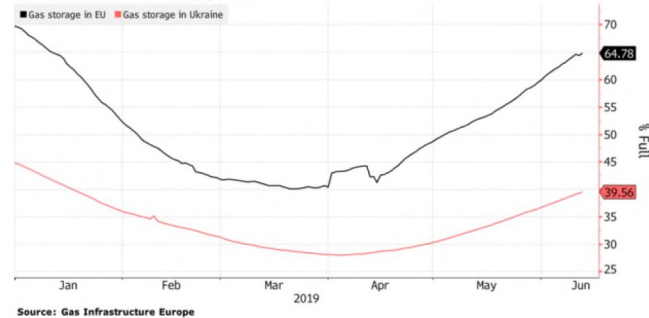
Source: Agency for Cooperation of Energy Regulators, 2017 data

Ukraine is offering access to its massive storage facilities and relying on financing from international financial institutions to boost their capacity so as to insure against the risk of a cut in Russian supplies. Russia hopes for a new transit deal and will discuss a date for trilateral talks with the European Union and Ukraine in September, Energy Minister Alexander Novak said this week.

More than a third of Europe's gas comes from Russia, and most of that goes through Ukraine's Soviet-era pipelines. Ukraine has proposed that the European Union store as much as 4 billion cubic meters of gas in its underground storage facilities to guarantee security of supply for eastern European countries heavily reliant on Russian gas, pipeline operator Ukrtransgaz said this week.

More Gas Storage

Europeans are rebuilding gas stocks



While Europe's gas markets are currently well supplied and prices are near their lowest in three years, traders are closely monitoring the dispute, which echoes a pricing conflict between the ex-Soviet nations that caused flows into Europe to be disrupted for almost two weeks in freezing weather in January 2009.

“We will see some bumps on the road but it will get to a conclusion,” said Guy Smith, head of gas trading at Vattenfall AB. “In the end, people will reach a sensible conclusion that will provide value for both sides.”

The progress made by Ukraine and Russia since last July would allow the parties to conclude a new contract quickly, Zerkal said. But Russian proposals to prolong old contracts “would mean to turn back in time to 2009” while it’s insistence to wait until the political leadership in Ukraine changes before resuming negotiations is pointless as the government position won’t change, she said.

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Transit via Ukraine will remain vital for Europe next winter because the Nord Stream 2 pipeline directly from Russia to Germany under the Baltic Sea is likely to be delayed, hindered by permitting processes in Denmark and threatened by possible U.S. sanctions.

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“We have a well-elaborated framework for further successful negotiations,” Zerkal said. “New contracts should reflect all lessons learnt by Ukraine and other European nations on what it means to transport Russian gas.”

– *With assistance by Mathew Carr, and Mikael Holter*

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JUNE 13, 2019

Nord Stream 2: From EU Law to US Sanctions Law

BY ALAN RILEY

(/blogs/energysource/nord-stream-2-from-eu-law-to-us-sanctions-law?tmpl=component&print=1)

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A Nord Stream 2 pipe laying vessel pictured off of Rügen island, Germany on October 7, 2018 (photo by Flickr/Jürgen Mangelsdorf).

Rainer Seele, the chief executive officer of Austrian energy company OMV and corporate ally of Gazprom, recently called on Europe (<https://www.ft.com/content/1e4d7f04-81f9-11e9-9935-ad75bb96c849>) to defend itself from the proposed US sanctions aimed to stop Nord Stream 2. It is far from clear to which 'Europe' Seele is referring. In December 2018, the European Parliament voted 433 to 105 (<http://www.europarl.europa.eu/news/en/press-room/20181205IPR20940/meps-commend-ukraine-s-reform-efforts-and-denounce-russian-aggression>) in favour of a resolution calling for the construction of Nord Stream 2 to be cancelled. Furthermore, in February 2019, twenty-four of the twenty-eight member states were prepared to vote (<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0692&qid=1560270096879&from=EN>) to amend the 2009 EU Gas Directive formally to import pipelines such as Nord Stream 2, creating uncertainty in the current financing, business structure, and commercial logic of the project.

Germany had too few votes from other member states to block the amendment to the Directive. It ended up bargaining with Paris for convoluted face-saving wording to cover up the fact that it had to substantively accept the application of the Directive to import pipelines.

As a consequence, Nord Stream 2 is now struggling with how to deal with the application of the Gas Directive. It faces, for example, having to unbundle the pipeline. Gazprom, which has a 100 percent shareholding in Nord Stream 2, can either own the pipeline or provide the gas; in any event, access to the pipeline will have to be opened up to via the EU's third-party access rules and a transparent cost reflective tariff regime would have to be applied. In addition, Gazprom would face having to endure a security of supply certification process. The supply certification process, mandated by Article 11 of the Gas Directive, requires an assessment to be made about whether or not an EU owner could undermine the supply security of the European Union. According to Larsson and Hedenskog, Russia has deployed coercive energy policies to Central and Eastern European (CEE) states over fifty times

(https://www.researchgate.net/publication/228877758_Russian_Leverage_in_the_Energy_Security_of_Central_and_Eastern_Europe) between 1991 and 2006. Such energy policies include supply cuts, coercive pricing policies, and sabotage. Gazprom was the dominant actor in sixteen

(https://www.researchgate.net/publication/228877758_Russian_Leverage_in_the_Energy_Security_of_Central_and_Eastern_Europe) of these cases. Even after the CEE states joined the EU, they have still been threatened with supply cut offs. This happened most notably in 2014 and 2015, when Poland, Hungary, and Slovakia shipped gas to help Ukraine, and Gazprom threatened to reduce (<https://www.osw.waw.pl/en/publikacje/analyses/2014->

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09-17/central-european-problems-russian-gas-supplies) gas supplies to those countries and then took steps to do so. As a consequence, Nord Stream 2 would face considerable practical and legal obstacles in obtaining certification under Article 11.

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The degree of Gazprom's distress can be seen in the April 12, 2019, letter from Nord Stream 2 Chief Executive Officer Matthias Warnig to Jean-Claude Juncker, president of the European Commission. Warnig threatened to sue the EU under the Energy Charter Treaty's investment protection regime (<https://www.politico.eu/wp-content/uploads/2019/04/Nord-Stream-2-ECT-letter-legal.pdf>). He alleged that the adoption of the Amended Directive targeted the pipeline in a discriminatory fashion. The letter argued that Nord Stream 2 had been deliberately targeted by the legislation and was the only pipeline subject to the new law where a final investment decision had already been made. This 'legitimate expectation' argument is weak because Nord Stream 2 started constructing the pipeline even without having all the route permits in place for the pipeline; for example, there is no Danish permit yet in place. Nord Stream 2 is locked in litigation with the Danish Energy Agency over which route should be assessed under its permitting process. Hence, Nord Stream 2 does not currently even have a complete definitive route.

If Warnig does follow through with yet more litigation, the European Commission is likely to respond robustly. The Commission will be able to point out how irregular it is in normal commercial practice to proceed with an investment without all the route permits in place. It is also likely to argue that commercial operations bear significant risks when investing in projects for which routes have not yet been approved via the permitting process.

Arguments in support of Nord Stream 2 suggest that, as the pipes for Nord Stream 2 have been constructed in German waters, the pipeline is consequently 'complete' in EU territory, even if it is not complete elsewhere (only 40 percent <https://www.spglobal.com/platts/en/market-insights/latest-news/natural-gas/050719-german-part-of-russias-nord-stream-2-built-legal-issues-loom-ns2>) of the pipeline has actually been laid so far). The argument here is that, as the German part of the pipeline was completed before May 23, i.e., before the amendment to the Directive came into force, the full force of the provisions of the Gas Directive does not apply (<https://www.consilium.europa.eu/en/press/press-releases/2019/02/13/gas-directive-provisional-agreement-on-new-rules-for-gas-pipelines-to-and-from-third-countries/>). This argument is likely to be dismissed by EU supreme court judges in Luxembourg as overly formalistic, if it ever reaches their court, since it overlooks the fact that the German part of the pipeline, as a pipeline capable of taking flows of gas, was not operational on the day the Directive came into force.

A substantial majority of member states have already dealt a significant blow (<http://www.europarl.europa.eu/news/en/press-room/20181205IPR20940/meps-commend-ukraine-s-reform-efforts-and-denounce-russian-aggression>) to Nord Stream 2 through both the European Parliament's support (<https://www.rferl.org/a/france-backs-changes-to-eu-energy-rules-seen-as-threat-to-nord-stream-2/29757783.html>) for the pipeline's cancellation and support for the amendment to the Gas Directive. This is the true European response to Nord Stream 2. In reality, Seele and his German allies represent only a small subset of European opinion.

In this context, the proposed targeted sanctions contained in the US Congress' Protecting Europe's Energy Security Act are appropriate and would receive substantial support from the twenty-four EU nations that were prepared to support the amendment to the Gas Directive. The core element of that Act would target vessels laying pipes at depths of 100 feet or more for the construction of Russian energy export pipelines. Sanctions could be imposed on foreign persons who have sold, leased, provided, or facilitated the provision of such vessels for the construction of Russian export pipelines. This is a laser-focused sanction regime that would make it much more difficult to continue with the pipe-laying process for both Nord Stream 2 and Turk Stream 2.

Some experts suggest ([/blogs/new-atlanticist.com/us-congress-would-undermine-transatlantic-alliance-with-nord-stream-2-sanctions](https://blogs.new-atlanticist.com/us-congress-would-undermine-transatlantic-alliance-with-nord-stream-2-sanctions)) that the Act could impact Western corporate allies of Nord Stream 2 such as OMV, Wintershall, and Shell. It is difficult to see how this could be the case. With Nord Stream, Western energy companies were shareholders in the company. As direct shareholders, Section 2 would potentially affect them. However,

Nord Stream 2 is wholly owned by Gazprom and Western corporate allies only raised some of the funds for the project. It is therefore doubtful that the proposed Act's [Section 2](https://www.congress.gov/116/bills/s1441/BILLS-116s1441is.xml) (<https://www.congress.gov/116/bills/s1441/BILLS-116s1441is.xml>), which applies to "foreign persons that have sold, leased, provided, or facilitated the provision of those vessels for the construction of such pipelines," extends to the Western corporate allies. The technical construction of Section 2 focuses on the direct provision of support for vessels, and pipeline laying. Therefore, involvement of Western corporate allies looks too remote. In any event, a definitional provision could be added to the Act to make it clear that Section 2 does not apply to Western corporate allies that are raising funds for the project.

Seele also is not supportive of the US sanctions, on the grounds that they are a US attempt to increase its access to European gas markets by blocking Russian access. However, this argument is difficult to sustain since Nord Stream 2 will bring no new gas into EU markets—it will merely switch gas supplied via the Ukrainian Brotherhood pipeline network into Nord Stream 2, just as with Nord Stream. Western energy companies supporting Nord Stream 2 argue that the pipeline is not a direct substitution for the Ukrainian gas and that some gas transit through Ukraine will still be necessary. It is true that Gazprom could still see a need for gas flowing via Ukraine and down the Balkan gas corridor, as Nord Stream flows would have difficulty reaching that part of the European network. However, it is planning to build Turk Stream 2, which [could replace](http://bruegel.org/2018/07/beyond-nord-stream-2-a-look-at-russias-turk-stream-project/) (<http://bruegel.org/2018/07/beyond-nord-stream-2-a-look-at-russias-turk-stream-project/>) the Balkan gas flows via Ukraine. A further difficulty with that argument is that when the opportunity has presented itself, Gazprom has sought to reduce the amount of gas going through the Ukrainian transit route and increase flows through Nord Stream. This was the case in 2016 when a new Commission exemption decision permitted Gazprom to use most of the Ostsee-Pipeline-Anbindungsleitung (OPAL) connecting pipeline, which takes gas from Nord Stream. The [immediate effect](https://www.osw.waw.pl/en/publikacje/osw-commentary/2017-01-17/opal-pipeline-controversies-about-rules-its-use-and-question) (<https://www.osw.waw.pl/en/publikacje/osw-commentary/2017-01-17/opal-pipeline-controversies-about-rules-its-use-and-question>) was to see an increase in the flow of gas through Nord Stream and a decrease in gas through the Ukrainian pipeline. As a result, given the inherently diversionary nature of the Nord Stream 2 project and the probability that it will not provide any additional gas supplies, US sanctions in respect of Nord Stream 2 are unlikely to increase the access to EU markets for US liquefied natural gas (LNG).

Another questionable argument lays out the decrease in natural gas production in Europe as a justification for Nord Stream 2 and a reason why the pipeline should not be sanctioned. It is true that EU domestic natural gas production has fallen. With the closure of the Groningen field, Western Europe's largest onshore field, by 2030, the EU will face a direct loss of 50 bcm of gas production. However, deploying Groningen as a justification for Nord Stream 2 is also undermined by the reality, as explained above, that Nord Stream 2 will provide no new gas—it will simply shift from the Ukrainian pipeline network to Nord Stream 2. Furthermore, Nord Stream 2 goes nowhere near Western Europe, which is the European region seeing the greatest decline in domestic gas production. Nord Stream 2's landing point is Greifswald on the northeast German coast. Its connecting pipeline, the Europäische Gas-Anbindungsleitung (EUGAL), has a carrying capacity equal to the total capacity of Nord Stream 2 (55 bcm) and will take Nord Stream 2's gas flows through eastern Germany to Poland and the Czech Republic. In other words, gas flows from Nord Stream 2 go in the wrong direction to address declining domestic natural gas production in Western Europe, even if Nord Stream 2 provided additional supplies of gas to the EU market, which it does not.

EU member states have already shown willingness to take measures against Nord Stream 2 in the shape of European Parliament support for the cancellation of the pipeline and the adoption of the amendment to the Gas Directive. The US Congress can now take an additional step that will underpin rather than undermine the transatlantic relationship: deploying the targeted sanctions proposed in the Protecting Europe's Energy Security Act to help secure the collective interests of the EU and the United States and stop Nord Stream 2.

Dr. Alan Riley is a senior fellow with the Atlantic Council Global Energy Center and has advised PGNiG (Polskie Górnictwo Naftowe i Gazownictwo SA, a Polish state-controlled oil and gas company) and Naftogaz, the national oil and gas company of

Ukraine. You can follow him on Twitter @profulanriley1

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